



PUBLIC EMPLOYEE RETIREMENT SYSTEM OF IDAHO
607 North 8th Street
BOISE, IDAHO 83702

MINUTES
OF
MEETING OF RETIREMENT BOARD

The Board of the Public Employee Retirement System of Idaho met at the PERSI Administration Building, 607 North Eighth Street in Boise, Idaho at 8:30 a.m. October 26, 2004. The following members were present:

Jody B. Olson
Pamela I. Ahrens
J. Kirk Sullivan
Clifford T. Hayes

Trustee Dennis Johnson was absent and excused. Executive Director Alan H. Winkle, Deputy Attorney General Brad Goodsell, Chief Investment Officer Robert Maynard, Financial Officer James Monroe and Management Assistant Joanne C. Ax were also in attendance. The electronic projection of materials and documents discussed in the meeting was handled by Betsy Griffith. Other persons attending portions of the meeting were:

Rod MacKinnon
Bill Palumbo
Drew Black
Brian McGrath
Casey Maslonka
Dennis Fitzpatrick
Jim Steele
Jim Coleman
Jim Shakelford
Connie Eshelman
Brent Nye
Dona VanTrease
Geoff Bridges
Robert Schmidt
Matt Freeman
Maria Barrett

Mountain Pacific Investment Advisors
Mountain Pacific Investment Advisors
DB Fitzpatrick & Co.
DB Fitzpatrick & Co.
DB Fitzpatrick & Co.
DB Fitzpatrick & Co.
DB Fitzpatrick & Co.
PERC – Retired Teachers
IEA
Endowment Fund
Boise Schools
IPEA
Milliman
Milliman
Legislative Budget Office
Division of Financial Management

Louis Henry
Doug Borah
Charlie Brown
Ann Heilman

Deloitte & Touche
PERC – Idaho Peace Officer Assn.
REAI
DHR

MINUTES

Approval of the Minutes: By motion duly made by Trustee Sullivan and seconded by Trustee Hayes, the Board unanimously approved the minutes of the September 23, 2004 regular meeting of the Retirement Board as submitted. In the same motion, the minutes of the September 30, 2004, Investment Sub-Committee meeting were approved.

PORTFOLIO

Private Equity: The Board had expected to hear from Mario Gianinni regarding private equity investments. Chief Investment Officer Robert Maynard told the Board that because of illness, Mr. Gianinni would attend the November meeting and discuss those issues.

Mr. Maynard said our private equity holdings now represent about 3% of our fund. He expects a continuation of the current direction and reinvesting of profits from this sector back into private equity until it reaches about 5% of the fund. Commitments to private equity investments may increase from the current \$20-\$25 million to \$40-\$50 million with more overseas investments.

Chairman Olson said he has been a supporter of private equity investments for many years and would not want to place a limit of \$50 million if our consultants find a good investment for us. Mr. Maynard replied that the \$40-\$50 million could be an average commitment and exceptions could be made. The program will be opportunistic; we will not be forcing funds into the allocation if the deals aren't there.

Chairman Olson noted the work of the Investment Sub-Committee is chaired by Trustee Ahrens. Mr. Maynard said that Trustee Sullivan will be a part of that committee. Trustee Sullivan will participate in the fixed income manager search, to include meetings with Callan in the coming weeks. He expects recommendations to be made at the November Board meeting.

Monthly Portfolio Update: Mr. Maynard had previously furnished his annual disclosure of his outside activities to the Trustees.

He began his investment presentation with a discussion of longer-term strategic Board policies and how they have affected the fund. Mr. Maynard recently attended a meeting of peers who compare their large, statewide fund data. Of the 54 funds, the data of 30 goes back 20 years which provides valuable historical comparisons. Mr. Maynard said all these institutional investors have a goal to make and preserve capital; they are not trying for monster returns. In general, when these funds face difficult times, it is usually not because of investment practices, but rather a result of mismanagement on the liability side. Of these peer funds, there is only about a 1% difference between the best and worst performers. One of PERSI's strengths is that the Board and management understand legislative and liability considerations.

Mr. Maynard's monthly investment report included the following CIO Comment:

The investment markets are continuing their generally mixed performance of the current calendar year, and still appear at best fairly, and probably slightly, overvalued. The uncertainty of the election cycle and the apparent slowing of both growth and corporate earnings, along with a worrisome energy market, have all combined to produce a sidewise yet choppy market environment. The overall fund is essentially unchanged since the last Board meeting and is currently slightly positive (+0.8%) for the fiscal year-to-date.

REITS, global equities, emerging markets, and TIPS continue to provide material additional returns for the fiscal year-to-date, also helped by private equity. Collectively, these portions of the PERSI portfolio have added 1.2% to total fund returns over market returns. The emerging market managers, Bernstein and Genesis, continue to have the best absolute returns, followed closely by the REIT portfolio managed by Adelante (formerly Lend Lease).

Bernstein Emerging has the best relative performance compared to their benchmarks), while the SGAM and TCW Domestic portfolios have the worst relative performance. The weakest overall part of the portfolio has been the performance of the active US managers, with Tukman, TCW Domestic, and Donald Smith all underperforming the general market (for reasons connected to their type of management).

All managers are either within their expected characteristics or have reasonable explanations for slight deviations. The portfolio's relative outperformance of the markets has picked up again over the past month, and still remains nicely positive for the fiscal year-to-date. The outperformance (or lack thereof) still is dependent on PERSI's major bets in global managers, REITs, TIPS and emerging markets.

Mr. Maynard said our global and emerging markets may do well in the coming months. REITs have had a tremendous run which may continue or may not. TIPS probably will not continue to outperform, but is there for diversification purposes, not for returns. Private Equity is starting to come back and return profits.

He told the Board that we are in the planning stage for the second PERSI investment manager conference in Boise. All of the investment managers who manage portfolios on our behalf will be asked to attend our conference, tentatively scheduled for June 8 - 9, 2005. This will provide

them with an opportunity to meet with the Trustees and discuss investment strategies and market overviews with one another.

Investment Manager Comments: The Chairman invited managers who were present to comment on the markets and the economy. There was agreement that the geo-political climate is continuing to affect the markets. Oil prices are continuing to rise and appear to be driven by demand rather than the usual control of supplies. The high oil prices seem to be slowing the economy, but managers expect the economy to stabilize soon.

EXECUTIVE DIRECTOR

FRF Preliminary Valuation: Actuary Geoff Bridges from Milliman distributed a draft of the FRF valuation results and discussed several charts. Most of the FRF members are retired, so liabilities should start to reduce.

Final Actuarial Valuation: Copies of the final PERSI base plan actuarial report were distributed to Trustees. Actuary Robert Schmidt said that in 2004 the plan reached a new highpoint in assets relative to prior years. However, actuarial projections forward to 2014 show that as the fund matures and greater numbers of members retire, we will experience a negative cash flow. There will not be enough coming in from contributions each month to pay the benefits and assets will need to be used.

The report showed a net increase in members of 1000, an increase of inactive members of about 200 and an increase in the number of annuitants of more than 1000.

Answering a question from Trustee Ahrens, Mr. Schmidt said the projections in the report assume only the automatic 1% COLA, not a discretionary COLA. He also confirmed that the projections assume that no more employees are added and that salaries increase at the assumed rate.

By motion duly made by Trustee Ahrens and seconded by Trustee Hayes, the Board unanimously approved and adopted the July 1, 2004 Actuarial Valuation as presented by the actuaries.

COLA Discussion and Decision: Executive Director Winkle reviewed charts that had previously been provided to the Board. Historical contribution rates, future contribution rates, the impact on employer and on employees as well as scenarios requested by Trustees were discussed.

Chairman Olson opened the discussion to interested parties. DHR Administrator Ann Heilman said she will be presenting a benefit analysis to the Governor on December 1. With state employee salaries 14% behind those paid by private sector employers and health benefit costs continuing to rise, she sees a difficult time coming up for the legislature. Trustee Hayes clarified that the decision before the Board was the retiree COLA, not the contribution rate increases. Dona VanTrease of IPEA said her organization represents both active employees and retirees. The retirees continue to deal with increasing expenses. Their prescription drug benefit is now capped, making securing needed medications challenging. They paid higher contribution rates into the PERSI fund when they were active than current members are paying. Active members of IPEA support the COLA, even with impending contribution increases, as they know they will depend on that benefit in their retirement years. Jim Shakelford of IEA said his organization

remains optimistic that the Board will award the discretionary and the retro-Cola for retirees. Medical insurance is a big issue for retirees and their Medicare premiums are increasing by 17%.

Trustee Sullivan said he struggles with awarding the COLA. However, he had reviewed what the Board has done in the past. By motion duly made by Trustee Sullivan and seconded by Trustee Hayes, the Board approved a 1.7% discretionary COLA and a .8 retro COLA. Trustee Ahrens voted No; Chairman Olson supported the motion.

Status Report: Mr. Winkle reviewed his report dated October 20, 2004, which had previously been provided to the Trustees. The RFP for Phase III of the BPR project is nearly ready for review by the Division of Purchasing.

Our legislation has been approved by the Governor's Office. Staff made a minor change to the bill dealing with the Police Officer definition, changing the wording regarding "paramedic and paramedic trainees" to match the state law which uses the EMT (emergency medical technician) designation.

According to the PERSI rules, the Regular Interest Rate and Reinstatement Interest Rate are established each calendar year. The Regular Interest Rate is the interest rate used to credit member accounts and is based on the return earned by PERSI for the previous fiscal year, less expenses, or cash rate (average of 13 week T-Bills) whichever is more. The actuarial report shows a net return of 17.51% which will be the Regular Interest Rate beginning January 1, 2005. The Reinstatement Interest Rate is calculated at 5.25% effective January 1, 2005.

Renaissance Charter School's last day in business was August 31, 2004. There were five employees. We are assessing whether there is an actuarial (withdrawal) cost.

New Employer: By motion duly made by Trustee Sullivan and seconded by Trustee Hayes, the Board unanimously approved The Valley Soil & Water Conservation District as a new PERSI employer with an effective date of October 1, 2004. They have one employee and five elected and appointed members. There are no entry costs for this employer to join PERSI.

FISCAL:

Travel, Administrative and Portfolio Reports: Mr. Monroe reviewed details of the Out of State Travel and Training report. He also reviewed the September Administrative and Portfolio budget reports that had previously been furnished to the Board. Trustee Ahrens said she has attended two conferences this year. Chairman Olson strongly encourages Trustees and senior staff to attend a couple of conferences each year to keep current on pension issues. Mr. Monroe's report noted that the annual budget request for PERSI was submitted to DFM and LBO on October 1. The final version included a minor change increasing the replacement software operating expense by \$26,200. The Administrative budget report shows there are four vacant positions. Two were filled internally, opening two more which will be filled as the Business Process Review progresses.

FY 2004 Audit Discussion and Adoption: Chairman Olson, acting as the audit committee, had spent several hours with Deloitte & Touche (D&T) and PERSI staff reviewing the auditors' report in detail. Mr. Olson also spoke with the auditors without staff present and said he is comfortable with the audit this year. D&T auditor Louis Henry told the Board his firm is waiting to fill in a few blanks with the FRF information that is just being completed by the actuaries. The State Controller's Office needs this approved report in order to complete the statewide financial statements. Board members expressed their reluctance to approve an audit report without complete numbers. After discussion, by motion duly made by Trustee Sullivan and seconded by Trustee Ahrens the Board unanimously approved the audit report contingent upon the FRF actuarial numbers being inserted in the report. A final report will be distributed at the November meeting.

LEGAL:

Ethics Law Presentation: Deputy Attorney General Brad Goodsell discussed three different acts in Idaho dealing with government ethics that could be applicable to PERSI Board Members in performing their duties. He discussed the laws prohibiting contracts with public officers, the Ethics in Government Act and The Bribery and Corrupt Influence Act. Trustee Ahrens asked if the standard for herself and Trustee Hayes would be higher because they are also public employees. Mr. Goodsell said the standard under these statutes is the same for all PERSI Trustees although their positions may pose additional considerations under their general fiduciary duties, as discussed by Joe Wyatt at the previous board meeting. To assist the Trustees in determining whether it is ethical to accept gifts from private interests, he recommended two "safe harbors": 1) do not accept gifts or benefits in excess of \$50 in value from anyone who does business with PERSI or is likely to become interested in doing business with PERSI (which is the amount considered in state law to be "trivial"), or 2) do not accept benefits unless the expenses for such expenditures would be reimbursable by the state if submitted for such purpose (such as attendance at a pension conference). Chairman Olson encouraged Trustees to use Mr. Goodsell as a resource if they have further questions on ethical issues.

FUTURE MEETINGS:

Discussing the proposed meetings for 2005, Chairman Olson asked that another draft be circulated. The meeting dates will be set at the November meeting. A combined November/December 2005 meeting will be planned. The meeting formerly set for December 14, 2004 will be cancelled.

Tuesday, November 30, 2004, 8:30 a.m. Boise - PERSI office
~~Tuesday, December 14, 2004, 8:30 a.m., Boise, PERSI office~~

Adjournment: Retiree representative Charlie Brown thanked the Board for the COLA and Retro-COLA saying his constituents will be satisfied with that decision. Chairman Olson thanked him for attending the meetings throughout the year. The meeting adjourned at 10:45 a.m.

Jody B. Olson
Chairman

Alan H. Winkle
Executive Director